



King County

June 30, 2003

**Honorable County Executive, Members of the
Metropolitan King County Council, and King
County Residents**

We are pleased to transmit to you the Comprehensive Annual Financial Report (CAFR) of King County, Washington, for the fiscal year ended December 31, 2002. This is the first year for several new reporting standards that have significantly impacted report presentation. The standards implement a new reporting model to provide a clear picture of the County as a single, unified entity, as well as continuing to provide traditional fund-based financial statements. Each perspective (government-wide and major fund) allows the reader to address relevant questions, provides a basis for comparison (year to year or government to government), and enhances the County's accountability.

The report is presented in three sections: Introductory, Financial, and Statistical. The Introductory Section includes this transmittal letter. The Financial Section begins with the independent auditor's report and contains management's discussion and analysis (MD&A), government-wide financial statements, fund financial statements, notes to the financial statements, required supplementary information, combining financial statements, and schedules. This letter of transmittal is designed to complement the MD&A, which presents a narrative introduction, overview, and analysis of the financial statements. The Statistical Section includes selected financial, economic, and demographic data.

The CAFR consists of management's representations concerning the finances of the County. Consequently, management assumes full responsibility for the completeness and reliability of all information presented in this report. To provide a reasonable basis for making these representations, management has established a comprehensive internal control framework that is designed both to protect the government's assets from loss, theft, or misuse and to compile sufficient reliable information for the preparation of the County's financial statements in conformity with Generally Accepted Accounting Principles (GAAP). Because the cost of internal controls should not outweigh their benefits, the County's comprehensive framework of internal controls has been designed to provide reasonable rather than absolute assurance that the financial statements will be free from material misstatement. As management, we assert that, to the best of our knowledge and belief, this financial report is complete and reliable in all material respects.

The County's financial statements have been audited by the Washington State Auditor's Office. The goal of the independent audit was to provide reasonable assurance that the financial statements of the County for the fiscal year ended December 31, 2002, are free of material misstatement. The independent audit involved examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; assessing the accounting principles used and significant estimates made by management; and evaluating the overall financial statement presentation. The auditor concluded, based upon the audit, that there was a reasonable basis for rendering an unqualified opinion that the County's financial statements for the fiscal year ended December 31, 2002, are fairly presented in conformity with GAAP. The auditor's report is presented as the first component of the financial section of this report.

The independent audit of the financial statements of the County was part of a broader, federally mandated "Single Audit" designed to meet the special needs of federal grantor agencies. The standards governing Single Audit engagements require the independent auditor to report not only on the fair presentation of the financial statements, but also on the audited government's internal controls and compliance with legal requirements, with special emphasis on internal controls and legal requirements involving the administration of federal awards. These reports are available in the County's separately issued Single Audit Report.

GAAP require that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement MD&A and should be read in conjunction with it. The County's MD&A can be found immediately following the report of the independent auditors.

Profile of the County

The County ranks number one in population in the State of Washington and is the financial, economic, and industrial center of the Pacific Northwest Region. Located between the sparkling blue waters of Puget Sound and the snowcapped Cascade Mountains, the County consists of 2,134 square miles, ranking 11th in geographical size among Washington State's 39 counties. As of December 31, 2002, the County contained 39 incorporated cities, which accounted for approximately 80 percent of its population.

King County operates under a Home Rule Charter adopted by a vote of the citizens of King County in 1968 and is organized under the Executive-Council form of county government. The Metropolitan King County Council is the policy-determining legislative body of the County. The Council's 13 members are elected by district to four-year staggered terms and serve on a full-time basis. The County Council sets tax levies, makes appropriations, and adopts and approves the annual operating budget for the County. Other elected county officials include the County Executive, Prosecuting Attorney, Sheriff, Assessor, and Superior and District Court Judges. All are partisan positions, elected at large to four-year terms, except for the Sheriff and Judges, which are non-partisan positions.

The County Executive serves as the chief executive officer of the County. The County Executive presents to the County Council annual statements of the County's financial and governmental

affairs, the proposed budget, and capital improvement plans. The County Executive signs, or causes to be signed on behalf of the County, all deeds, contracts, and other instruments, and appoints the director of each executive department.

King County provides some services on a countywide basis and other services only to unincorporated areas. Within appropriate jurisdictions, the County provides public transportation, road construction and maintenance, water quality, flood control, parks and recreation facilities, court services, law enforcement, agricultural services, inquests, tax assessments and collections, fire inspections, planning, zoning, animal control, criminal detention, rehabilitative services, public healthcare, election administration, and the processing and disposal of solid waste. In addition, the County has contracts with some cities to provide services to incorporated areas within County.

The reporting entity "King County" includes three component units: (1) the Harborview Medical Center (HMC); (2) the Washington State Major League Baseball Stadium (WSMLB) Public Facilities District (PFD); and (3) the Flood Control Zone Districts. The Harborview Medical Center, with a history dating back to 1877, is a comprehensive 413-bed healthcare facility operated by the University of Washington since 1967 under a management contract. The general conditions of the management contract specify that King County retains title to all real and personal property acquired for King County with HMC capital or operating funds. The PFD is responsible for overseeing the maintenance and operation of Safeco Field, the Seattle Mariners' baseball stadium. The Flood Control Zone Districts account for the undertaking, operation, or maintenance of flood control projects or storm water control projects that are of special benefit to specific areas of the County.

Most funds in this report pertain to the entity King County Government. Certain Agency Funds pertain to the County's custodianship of assets belonging to independent governments and special districts. Under state statute and the County's Home Rule Charter, the King County Executive is the *ex officio* treasurer of all special purpose districts in King County, but not of cities and towns. As provided by County ordinance, the Director of the Finance and Business Operations Division is responsible for the duties of the comptroller and treasurer. Monies received from or for the special purpose districts are deposited in a central bank account. The Director of the Finance and Business Operations Division invests or disburses monies according to the instructions of the respective special purpose district's governing body or administrative officer.

Factors Affecting Financial Condition

The information presented in the financial statements is perhaps best understood when it is considered from the broader perspective of the specific environment within which the County operates.

Local economy. Economic conditions have a direct impact on the County's revenues and demand for County services. The County's General Fund revenue sources include taxes, charges for services, and intergovernmental revenues. The largest single source is taxes, which comprise approximately 60 percent of total General Fund revenue and consist primarily of taxes on real property. The property tax tends to be quite stable due to its relationship with

assessed value. Other tax sources, such as the retail sales tax, are much more volatile and directly influenced by economic conditions in the region.

After entering a moderate recession in the second quarter of 2001, King County continued to experience poor economic conditions in 2002. Unemployment remained high at roughly 60,000 workers (or 6 percent) over the course of the year. The general collapse in stock market values in the second and third quarters of 2002 continued a trend that started with technology equities in 2000. As a consequence, personal income continued to stagnate with virtually no growth attributable to stock option appreciation. The tight labor market for skilled technical workers of the late 1990s is now characterized by surplus, with a growing list of defunct internet-related firms.

For the second consecutive year, total retail sales tax receipts in the County (excluding those collected for transit) declined, falling 3.1 percent in 2002. General Fund sales tax collections fell by 3.08 percent in 2002. Property value growth slowed significantly, with assessed valuation up just 6.6 percent in 2002, compared with a 12 percent growth in 2001 and a 13.3 percent growth in 2000. This decline is attributable to the ailing commercial real estate market; residential values remained exceptionally robust throughout the year, buoyed in large measure by historically low interest rates.

Economic outlook. For 2003 a more robust national recovery is expected to gradually lead to improving local conditions. As structural changes continue, no net change is anticipated in total regional employment in 2003. Constrained by high unemployment and three years of retrenchment in the technology sector, personal income is projected to grow at an anemic 2.1 percent, only one-tenth of one percent above 2002 levels.

The County will continue to face numerous challenges, including volatile energy prices and the need to raise sufficient revenues to pay for the operations of its utilities, transit system, and general government operations.

Long-term financial planning. King County faces substantial structural imbalances in the General Fund, stemming from Initiative 747's tight constraints on property tax revenue. With property tax growth capped at approximately 2.1 percent over the coming years (Initiative 747 caps property tax levy increases at 1 percent per year plus new construction), and the County's long-term cost structure growing by 5-6 percent per year, driven by labor costs and service utilization levels, substantial shortfalls will continue for the foreseeable future.

To date, the County has aggressively managed the budget through sharp spending reductions to maintain both a balanced financial position and a steadfast commitment to the County's 6 percent undesignated reserve policy which requires an undesignated fund balance in the General Fund of at least 6 percent of revenues. The County plans to continue this strategy in the future, and the often painful process of reducing expenditures to match revenue levels while retaining prudent reserves. At the state level, the County also continues to pursue statutory enhancements to local government revenues to address the long-term structural imbalance.

Major Initiatives

Parks

In response to the \$52 million General Fund revenue shortfall in the 2003 King County Budget, the Parks Division of the Department of Natural Resources and Parks (DNRP), reduced its operating budget by \$10 million dollars, or roughly 40 percent. This reduction has been accomplished through a variety of innovative and entrepreneurial methods, including the transfer of 7 in-city (local) swimming pools and 12 in-city parks to King County cities; the temporary closure or "mothballing" of other in-city [local] parks and pools until such time as they are able to be transferred or reopened under operating agreements with other funding organizations; the reduction of 53 additional Parks staff; increasing a number of Parks' facility user fees and instituting new fees (e.g., parking fees at Marymoor Park) in order to generate additional revenue to start to approach full-cost recovery where appropriate; and developing other [new] revenue-generating ideas such as the potential for a golf driving range at Marymoor Park and a new summer concert series, also at Marymoor Park. The efforts started in 2002 and will continue into the future as the Parks Division continues to innovate and develop its way out of the current King County budget crisis. In May 2003 voters authorized King County to exceed chapter 84.55 RCW regular property tax limitations and levy an additional regular property tax of 4.9 cents per \$1,000 of assessed valuation for four consecutive years (with collection beginning in 2004) to fund continued and increased operation and maintenance of King County's regional parks, rural parks, recreation facilities, and to fund recreation grant programs.

Cultural Development Authority

In 2002 King County created the Cultural Development Authority (CDA) to administer the King County Arts and Heritage Program. This substitute for the Office of Cultural Resources was designed to make cultural programming more effective and entrepreneurial while reducing reliance on County resources. Consistent with this plan the 2003 budget did not include any appropriation for FTEs for the Office of Cultural Resources or the Department of Cultural Development. An appropriation of \$7.7 million was made to the Arts and Cultural Development Fund that will support the following program areas: stewardship of the County's public art collection; selected administrative costs of the newly created Cultural Development Authority; the Public Art Program funded by contributions from eligible capital projects; and the range of Arts and Heritage Programs which have been funded by Hotel-Motel Tax revenue. An appropriation of \$13 million was provided to transfer existing fund balances to the CDA, which will enable it to carry on the programs and projects formerly managed by the Office of Cultural Resources.

Departmental Reorganization

Effective January 1, 2002, the County enacted the most significant reorganization of county government since the Metro-King County merger. The reorganization of four departments and offices (Finance, Construction and Facilities Management, Information and Administrative Services, and Human Resources Management) into the Department of Executive Services (DES) resulted in savings to the County of nearly \$8 million and General Fund savings of over

\$4 million. In June 2002 the Executive further reorganized Executive Offices, eliminating the Office of Regional Policy and Planning and realigning Executive personnel along four functional lines: Policy and Strategy, Management and Budget, Operations, and Business Relations and Economic Development in order to strengthen management and leadership and achieve further cost savings of over \$950,000 in 2003.

Benefit Program

The Joint Labor Management and Insurance Committee reached consensus on a new three-year benefits package that will be implemented in 2003. During 2002 the Human Resources Division completed requests for proposal and new plan implementation and open enrollment processes for all medical, dental, vision, life, accidental death and dismemberment, and long term disability programs, resulting in substantial reduction in projected costs.

Cash Management Policies and Practices.

The Revised Code of Washington (RCW) allows King County to invest its surplus funds in U.S. Treasury and Agency securities, certificates of deposit, commercial paper, bankers' acceptances, and repurchase agreements secured by eligible securities. With the exception of one fund, all County monies are invested in the County's Investment Pool.

County investment policies establish investment parameters for operation of the investment pool. King County minimizes credit and market risks while maintaining a competitive yield. During 2002 the County's pool realized an average yield of 3.73 percent, down from 5.56 percent in 2001. Interest earnings of County funds in 2002 were over \$56 million, including over \$13 million for the General Fund. Ninety-seven percent of the deposits and investments held by the County as of December 31, 2002, are classified in the category of lowest credit risk in accordance with criteria established by the Governmental Accounting Standards Board.

Risk Management.

As a municipal organization, the County has a wide range of loss exposures. The County uses three internal service funds to account for and finance property/casualty, workers' compensation, and employee medical and dental benefits self-insurance programs. Note 9 to the financial statements discloses the specific programs and claims liability changes during 2002 for each insurance program.

Pension Benefits.

Qualifying County employees participate in the Public Employees' Retirement System (PERS), the Law Enforcement Officers' and Fire Fighters' Retirement System (LEOFF), or the Seattle City Employees' Retirement System (SCERS). PERS and LEOFF are statewide local government retirement systems administered by the State of Washington's Department of Retirement Systems under cost-sharing, multiple-employer defined benefit public employee retirement systems. Note 7 to the financial statements presents plan descriptions and information on funding policies.

Awards and Acknowledgements

The Government Finance Officers Association (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the County for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended December 31, 2001. This was the 21st consecutive year that the County has received this prestigious award. In order to be awarded a Certificate of Achievement, the government must publish an easily readable and efficiently organized CAFR. This report satisfied both GAAP and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current CAFR continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

The preparation of this report would not have been possible without the efficient and dedicated services of the Financial Accounting staff of the Finance and Business Operations Division. We would like to express our appreciation to all members of the division who assisted and contributed to the preparation of this report. Credit also must be given to the Executive and County Council for their support for maintaining the highest standards of professionalism in the management of the County's finances.

Respectfully submitted,



Robert V. Cowan
Finance Director
Finance and Business Operations Division

Connie L. Griffith
Chief Accountant/Manager
Financial Management Section